INVESTMENT GUIDE

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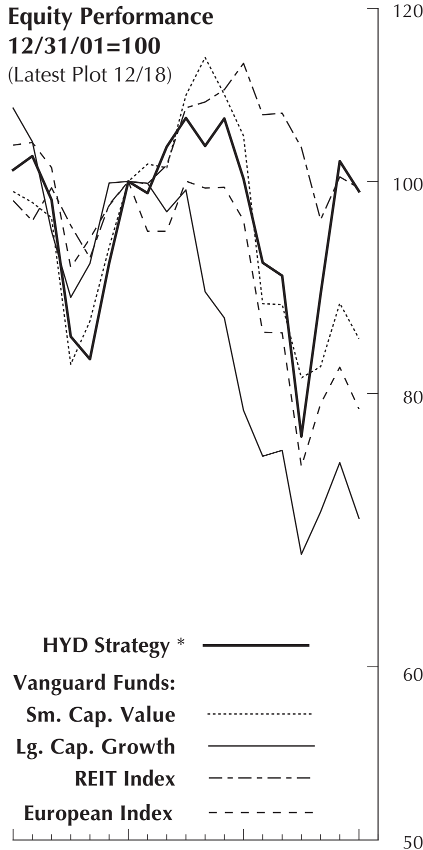


*** HYD is a hypothetical model based on back-tested results. See p. 94 for a full explanation.**

We offer two discretionary management services: Our Professional Asset Management (PAM) service covers all of our recommended assets and allows us to place trades in stocks, bonds, and mutual funds directly in our clients' accounts. (The accounts remain the property of our clients at all times—we are only authorized to trade on their behalf.) Our High-Yield Dow (HYD) service operates similarly, except it invests only in the highest-yielding Dow stocks, using the 4-for-18 model on a fully invested basis. Investors interested in these low-cost services should contact us at 413-528-1216 or Fax 413-528-0103.

Online: www.americaninvestment.com

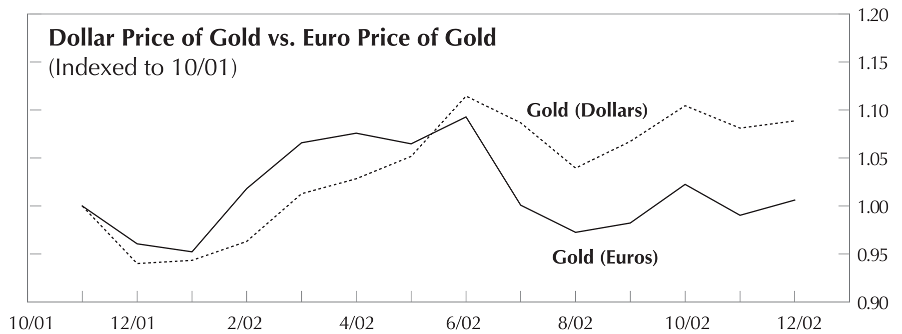
All That Glitters

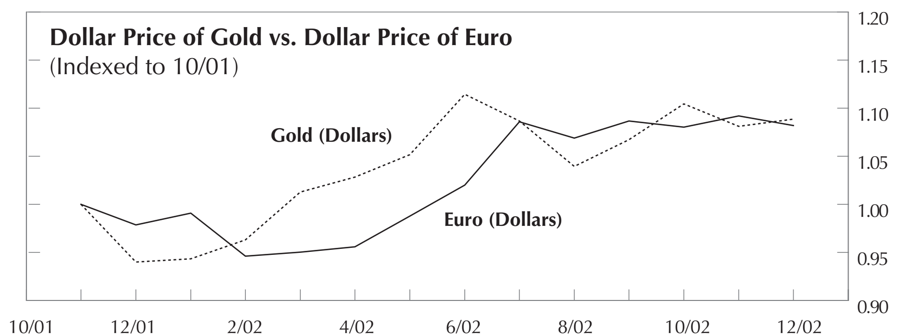
Investors who have heeded our advice to hold gold related assets have seen the dollar price of gold rise appreciably in recent weeks. As of December 19th the price stood at $345 per ounce, a price not reached in six years.

A rising chorus of voices, largely those of gold enthusiasts, is proclaiming (yet again) the emergence of a sustained bull market in gold. Many factors have been cited, especially looming military action in Iraq, as reason to buy gold now. While we favor gold in reasonable proportion as a form of insurance, we do not recommend that investors increase their exposure based on world events.

The first chart below demonstrates that while the dollar price of gold has indeed risen sharply since October of 2001, the Euro gold price has fallen back nearly to its level at that time. The second chart tells the same story a different way; the dollar gold price has risen but this largely reflects a depreciating dollar vis-à-vis the Euro. The point is we are not convinced that we are necessarily witnessing a global flight into gold; current prices instead suggest a flight away from dollar, as a U.S. war looms.

Most investors with a relatively long-term planning horizon should continue to devote between five and ten percent of their assets in gold related assets, and occasionally rebalance their portfolios by selling appreciated assets and reinvesting in those that have fallen in value, to maintain their desired asset allocations. The vast majority who do so stand a far better chance of meeting their goals than those who succumb to the temptation of chasing the latest rising star.





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ANOTHER LOOK AT FIXED ANNUITIES

The steep and prolonged decline in the stock market has led to renewed interest among investors in safe investments that promise a predictable yield. But with interest rates at 40-year lows, they are also looking for alternatives to CDs and money-market funds. One option is a fixed-rate annuity. Insurance companies heavily market them and sales have recently increased. Before investing in one, however, you should carefully consider their advantages and disadvantages.

An annuity is a contract with an insurance company in which the company promises to pay a stream of income payments to you. Immediate annuities begin paying income immediately. Deferred annuities—the focus of this report—delay the income payments, often for many years. During the deferment period the investor's funds accumulate with interest. Deferred annuities may be purchased with a single (often large) premium or with multiple premiums paid over a number of years. Multi-premium annuities may have fixed premiums or, more commonly, flexible premiums that allow you to contribute as much as you want whenever you want, much like investing in a mutual fund.

There are three types of deferred annuities. Variable annuities allow you to invest your funds among a family of stock, bond, and money-market funds. Investment return varies with the performance of the funds. Fixed annuities provide a guaranteed rate of return for periods ranging from one year to 10 years. Hybrid annuities combine the features of variable and fixed annuities. An example is equity-indexed annuities, which are invested in a stock index but promise a guaranteed minimum return. Our focus here is on the most conservative type of policy, the fixed annuity.

Tax Advantages

A chief advantage of deferred annuities is that you pay no income tax on the investment gains in your account until you take withdrawals. However, when you do withdraw funds, investment earnings will be taxed at ordinary income-tax rates rather than lower capital-gains rates. If withdrawals are taken before you reach age 59 1/2, you may also have to pay a 10 percent Federal tax penalty, similar to the penalty for early withdrawals from IRAs.

IRAs, 401(k)s, 403(b)s and other retirement vehicles also allow you to defer taxes on your investment earnings. However, these alternatives provide the additional benefit of allowing you to deduct your contributions from your taxable income. Most investors should not consider buying an annuity unless they have already made the maximum allowable contributions to these plans.

If you invest your IRA or other tax-sheltered retirement account in a deferred annuity, you get no additional tax benefit. The funds in an IRA are already tax-deferred, so the tax-deferral provided by the annuity adds nothing. In addition, putting your IRA in a deferred annuity reduces your flexibility to take withdrawals, because withdrawals in the early years of the contract usually are subject to surrender charges (discussed below).

One frequently cited advantage of annuities is that they are not subject to probate upon your death. However, the same applies to IRAs and other retirement accounts. The key to avoiding probate is to name a valid beneficiary on the account. Annuities, IRAs, 401(k)s, etc. will be subject to probate if you fail to name a beneficiary, or if the named beneficiary is deceased at the time of your own death, or if you leave the assets to your estate.

Guaranteed Returns but Large Fees

The rate of return on a fixed annuity depends on the interest rate set by the company. This rate is fixed for a period of time, sometimes a year, but often longer, after which the company is free to change the rate. Some insurers offer relatively high rates for the initial period, but there is no guarantee that the renewal rate will remain as attractive. However, the rate usually is guaranteed not to fall below a minimum during the life of the policy, typically about three percent. It is important to find out how long the current rate is guaranteed and what the minimum guaranteed rate is.

Insurance companies have to cover three costs: administrative, mortality (to cover death benefits), and marketing, which includes the cost of agents' commissions. The costs of marketing and commissions can be substantial, and the total fees levied on annuities typically are larger than they are for, say, mutual funds. Most of these charges are factored in and reflected in the quoted yield rather than deducted from it. Some policies also charge an initial sales load.

Special features may carry additional charges. For example, if you die, your beneficiary will usually receive all of the money in your account, but some policies pay an additional death benefit equal to a percentage of the account, or an extra benefit for accidental death. Other policies allow you to add long-term care insurance, which pays for nursing home care. Others may wave surrender charges for withdrawals taken when you are seriously ill. These and other features carry a price. Policies with more bells and whistles are apt to pay a lower rate of return or carry higher surrender charges and other fees.

Policyholders are subject to surrender charges if they withdraw part or all of the investment. These typically range from one to 10 percent of the amount withdrawn but can range as high as 12 percent. Surrender charges usually are highest during the first year of the contract and typically are phased out over seven years or so, although some run as long as 15 years. On a typical policy the surrender charge might be eight percent in the first year, seven percent in the second year, six percent in the third year, etc. Many policies allow you to make limited withdrawals free of surrender charges. For example, you might be able to withdraw the monthly interest or up to 10 percent of the account's value each year without penalty.

Some multi-premium policies start the surrender-charge schedule over again each time you make a new payment. Also, if you decide to exchange an existing annuity for a new policy—perhaps because the new one offers a better rate, or you are concerned about the financial strength of the insurance company that sponsors

Contact Information for the Rating Companies

A.M. Best Company
Ph: 908-439-2220
www.ambest.com

Fitch Ratings
Ph: 800-893-4824
www.fitchratings.com

Moody's Investors Service
Ph: 212-553-0377
www.moodys.com/insurance

Standard & Poor's
Ph: 212-438-2400
www.standardandpoors.com

Weiss Ratings
Ph: 800-289-9222
www.weissratings.com

your current policy—the new annuity typically will impose a new surrender-charge period.

Before buying a policy you should ask for an explanation of all charges. Aviod policies that impose tight restrictions and steep charges on withdrawals. Investors also should avoid deferred annuities altogether unless they expect to leave their funds invested long enough to avoid surrender charges.

Choosing a Company

Your investment in a fixed-rate annuity is only as sound as the insurance company that stands behind it. Unlike bank accounts, annuities are not backed by Federal guarantees. (This applies even to annuities sold by banks.) It is rare for an insurance company to fail, but if it happens, you are at risk of losing some or all of your investment. When companies failed in the early 1990s, death benefits were delayed and annuity benefits were reduced. At a minimum, you face uncertainty over the future of your policy and the aggravation of dealing with a failed company and the state insurance regulators overseeing it.

This is a particular concern when you buy a fixed-rate annuity, because the premiums paid into such annuities may be held by the company in a pooled account of general funds. If the company becomes insolvent or declares bankruptcy, these pooled funds could be used to satisfy creditors. In contrast, when you buy a variable annuity your funds are registered in a separate account of the company and thus are protected from creditors' claims against the company. (A growing number of companies place the premiums for fixed-rate annuities in separate accounts as well.)

Thus you must check the financial standing of the insurance company before buying a policy and periodically afterward. There are five major rating services that evaluate the financial strength of life insurance companies. Each has its own methods. The roughly comparable ratings are shown in Table 1 below.

Few companies are top-rated by every agency. Weiss Research uses an especially conservative approach and rates only a few companies as superior. Look for a company that is highly rated by most agencies and be wary if it receives more than one low rating.

You can obtain these ratings from an insurance agent, or your local library may have them. The rating firms also offer their ratings on-line, over the phone, and in written reports. Some firms provide the ratings for free but charge a fee for reports that explain their analysis. See the adjacent box for contact information.

A comprehensive, independent source for these ratings is *The Insurance Forum*, a monthly newsletter edited by Joseph Belth, a frequent critic of the insurance industry. The September issue rates every life insurance company rated by A.M. Best, Fitch, Moody's, Standard and Poor's, and Weiss. It includes an explanation of each firm's ratings system (an "A+" may look like a top rating but, as shown in Table 1, for two firms it is only the fifth highest ranking.) It also includes a watch list of insurance companies that appear to be financially vulnerable.

This information is invaluable for anyone who is planning to buy or already owns an annuity. The September ratings issue costs $20. Inquiries should be directed to *The Insurance Forum*, P.O. Box 245, Ellettsville, IN 47429, or telephone (812) 876-6502. You can get further information at www.theinsuranceforum.com.

Table 1: **DESCRIPTION OF MAJOR RATINGS SYSTEMS**

	A. M. Best	*Fitch*	*Moody's*	*Standard & Poor's*	*Weiss Research*
Superior	A++	AAA	Aaa	AAA	A+
Excellent	A+	AA+	Aa1	AA+	A
	A	AA	Aa2	AA	A–
	A–	AA-	Aa3	AA–	B+
Good	B++	A+	A1	A+	B
	B+	A	A2	A	B–
		A-	A3	A–	C+
Adequate	B	BBB+	Baa1	BBB+	C
	B–	BBB	Baa2	BBB	C–
		BBB-	Baa3	BBB–	D+
Below Average	C++	BB+	Ba1	BB+	D
	C+	BB	Ba2	BB	D–
		BB-	Ba3	BB–	E+
Weak	C	B+	B1	B+	E
	C–	B	B2	B	E–
	D	B-	B3	B–	
Nonviable	E	CCC+	Caa1	CCC	F
	F	CCC+	Caa2	CC	
		CCC-	Caa3	R	
		CC/C	Ca		
		DDD	C		
		DD/D			

Shopping for a Policy

The simplest way to comparison shop for an annuity is over the Internet. Most sites are little more than marketing tools or referral services that put you in touch with an agent, but some allow you to search large databases of annuities from many insurance companies to find policies that meet selected criteria. Two useful sites are quotesmith.com and annuity.net. Both provide detailed policy descriptions, the latest financial ratings of the insurance companies, and information on current rates, guaranteed rates, and surrender charges.

A recent check of these sites showed that annuities now pay minimum guaranteed rates ranging from 4.5 percent to three percent, with the rates guaranteed anywhere from one to 10 years. Many policies are offering additional bonus rates during the first year, some as high as 10 percent, and rates paid in subsequent years may be higher than the guaranteed minimum. Policies with very high bonus rates often carry higher surrender charges and restrictions, however, which may offset the benefit of the higher rate.

For example, one policy we reviewed promises a 13.58 percent guaranteed rate for the first year, but to get this rate you have to hold the policy for at least five years and eventually take the accumulated value as a stream of payments over at least 10 years. If you take the surrender value instead, the guaranteed rate of return is just 0.85 percent per year after five years and 1.9 percent after 10 years. This shows why it is important to check the fine print.

Fixed annuities seem like a simple product but actually they are quite complex and confusing. With low guaranteed yields, it is especially important to understand the terms of the contract before committing your funds. Above all, remember that high surrender fees make annuities suitable only as a long-term investment.

EQUITY INDEXED ANNUITIES: SORRY, NO "FREE LUNCH"

Investors, burned by a severe bear market and faced with negligible interest rates among fixed-income securities, are ripe for the picking by sharp salesman. In this environment, the insurance industry has been aggressively marketing equity-indexed annuities, which claim to offer precisely what jaded investors long for: participation in any "upside" in the stock market, with "guaranteed downside protection." This claim alone should arouse suspicion, and indeed, we recommend that investors avoid them in favor of a well-allocated portfolio of more conventional investment vehicles.

Equity indexed annuities (EIAs) are a hybrid type of deferred annuity; they share characteristics of fixed and variable annuities. EIAs offer a guaranteed minimum interest rate, touted as a "floor," as well as an interest rate tied to a market index. Very often the S&P 500 is the index of choice, though others are available. Thus, their returns are more volatile than those of fixed annuities, but are less volatile than variable annuities. Of course risk and return go hand in hand; other factors equal (e.g., fees), EIAs' expected returns lie above those of fixed annuities and below those of variable annuities.

It is important to understand that an EIA is an investment contract. It is not an investment in stocks or an equity fund. As investment vehicles, variable annuities are securities registered with the Securities and Exchange Commission, but EIAs are not. They therefore are not subject to the disclosure or sales-practice requirements that apply to more traditional variable annuities.

Downside "Protection"

The downside-protection feature of an EIA is a guaranteed value (the minimum available for withdrawal) often calculated as 90% of your premium plus 3% annually. In light of current interest rates, a 3% rate might sound attractive, but it is important to note that since the end of World War II price inflation has averaged over 4% annually. So, considering that you begin with a 90% base, if the equity index does poorly and this minimum floor applies in any given year, you could lose money in nominal terms, and even more in inflation-adjusted dollars.

Suppose you pay a $50,000 premium for an EIA with this feature, and that a bear market prevails for two years, while inflation averages 3.5% annually over the period. Your guaranteed value will be $47,740 after 2 years, representing only $44,551 in purchasing power. In addition, the guarantee is only as strong as the solvency of the insurance company providing the guarantee. Moreover, all deferred annuities are appropriate only as a long-term investment, thus the guarantee is valuable only in the unlikely event that you would have to turn to your EIA to meet some unforeseen event, but this withdrawal could be quite costly. Most EIAs impose surrender charges for withdrawals taken over the first five to seven years of the contract, some as high as 9% in the first year. In addition, any gains will be taxed as ordinary income, and if taken before age 59 1/2, a 10% income tax penalty would apply.

The Downside of the Upside

Our greatest concern with EIAs, however, is not with the downside protection but with the so called "upside potential" they are said to provide. Because these are unregulated contracts, the methods for computing and crediting index-linked interest vary considerably among EIAs, and even the most diligent investor must read the contract very carefully. The contract's "fine print" can dramatically impact the growth of the investment.

The index-related interest rate is impacted by a host of parameters, the most significant of which are *participation rates, fees*, and *interest-rate caps*. The participation rate is that percentage of the gain in the index that gets credited to the annuity, and it can vary between 50% and 100%. Thus you could buy a contract that will only participate at half the rate of growth of the market. Your returns can also be limited by fees. These are spread, margin, or asset-based fees that are subtracted from any gain in the index, and can be in lieu of or in addition to participation rates. Interest-rate caps might also be imposed, which simply place a ceiling, sometimes as low as 8%, on the rate of interest that can be earned. This could essentially render the notion of "market-linked growth" meaningless. The S&P 500 returned 13.1% annually between January 1974 and December 2001; in 17 of those years the index returned more than 8%, during which a contract with a simple 8% cap would have missed out on 69% of the market's gains, on average.

Even if these parameters appear reasonable, investors must be on guard, since participation rates, fees, and rate caps can all potentially be changed at the end of a contract term, which could be as short as one year.

In addition there is no standardized method for calculating the amount of interest credited for a given change in the index. EIAs even differ with matters as fundamental as compounding. Some pay only simple interest, based on the premium paid, but not on prior interest earned during the term, while others will compound interest earned during the term.

Common interest-crediting methods include *annual reset, high-water mark,* and *point-to-point* calculations. Under the annual reset method the index-based interest is calculated each year by comparing the index value at the beginning and end of each contract year, ignoring declines. On its face this method would appear to be more generous than others during periods of market volatility, but this feature is typically coupled with restrictive caps or frequently changing participation rates.

The high-water mark calculates interest using the highest index value at certain points during the term of the contract, often on the contract anniversary. This method therefore might generate a higher rate of interest than other methods, and protects against subsequent declines in the market during the period after the peak has been reached. But this technique is often combined with restrictive participation rates or caps, and interest is not credited until the end of the term, so early surrender could result in loss of any index-based interest earned during the period.

The point-to-point method compares the index values at the beginning and end of the entire term. The downside here is that only two data points are used, so a sudden decline in the market at the end of the period can quickly eradicate any gains. In addition, interest cannot be added until the end of the term, which could be seven years, so a premature withdrawal will result in forfeiture of any interest. These negatives are often mitigated by higher participation rates or higher rate caps.

Almost all EIAs exclude any dividends when computing interest based on an index; the S&P 500, which is most frequently used, is a price index only. The table below demonstrates that dividend exclusion can have a significant impact when comparing EIAs with the alterna-

tive of holding common stocks or mutual funds directly.

The complex nature of these calculations makes it very difficult to shop around and compare EIAs, and this is further complicated by the structure of the insurance industry. Typically a salesman will present only the product sold by his firm, for which he receives a commission. He therefore will not offer competing products, and is likely to discourage you from looking elsewhere.

Equity indexed annuities sound very appealing, but should be avoided. You are better off maintaining your own portfolio, designed to accommodate your tolerance for risk, using the investment vehicles we recommend. If you seek help from a financial services professional, we strongly recommend that you avoid anyone compensated for selling a particular product. Instead you should seek a fee-only, registered investment advisor who is free to recommend any investment from the universe of financial assets available, and whose only interest is recommending well-diversified, low-cost investment vehicles representing those asset classes best suited to meet your needs.

	12/1974-12/2001	**12/1926-12/2001**
	Annualized Returns	
S&P 500 Total Return	14.80	10.71
S&P 500 Income Return (dividends)	3.56	4.33
S&P 500 Capital Appreciation Return	10.88	6.12

REMINDER: TAX SAVINGS FOR THE NEW YEAR

The Economic Growth and Tax Relief Reconciliation Act of 2001 enhanced qualified plans and Individual Retirement Accounts (IRAs) by increasing the amounts that can be contributed annually and given tax-deferred status. Like other increases in benefits made in the act, most of these increases in the annual tax-deferred contributions to qualified plans and IRAs are being phased in (but like virtually all of the act's changes, these changes are to be effective only through 2010 absent future legislation continuing them in effect).

For IRAs, including Roth IRAs, the annual maximum contributions are as follows:

Years	*Maximum Contribution*
2002	$3,000
2003-04	$3,000
2005-07	$4,000
2008	$5,000

After 2008, the annual maximum contribution is to be increased to reflect increases in the cost of living, but it will be increased only when cost-of-living increases support a $500 increase over the preceding maximum contribution. In addition, individuals fifty or older can make additional "catch up" contributions to IRAs of $500 per year in 2002 through 2005 and of $1,000 from 2006 through 2010.

The annual maximum contribution to a 401(k) plan, a tax-sheltered annuity (a 403(b) annuity), or a salary reduction simplified employee pension plan ("SEP") are as follows:

Years	*Maximum Contribution*
2003	$12,000
2004	$13,000
2005	$14,000
2006 through 2010	$15,000

Similarly, the maximum annual deferral under a deferred compensation plan of a state or local government or a tax-exempt organization ("a 457 plan") is the same amounts as the maximum contributions under the preceding chart. After 2006, like the annual maximum contribution to IRAs, the annual maximum deferral under 401(k) plans and the other above-described tax-deferred arrangements will be increased to reflect cost-of-living increases, but only when the cost-of-living increases support a $500 increase in the previous maximum.

Moreover, employees fifty or more can make additional "catch up" contributions to a 401(k) plan, a 403(b) annuity, a SEP, or a 457 plan, and those contributions will also be tax-deferred. The "catch up" contributions that can be made on a tax-deferred basis to these plans are as follows:

Years	*Contribution*
2002	$1,000
2003	$2,000
2004	$3,000
2005	$4,000
2006 through 2010	$5,000

The $5,000 amount will be increased in $500 increments when such an increase is supported by increases in the cost of living.

In addition, employees have a shorter waiting period before becoming fully vested in an employer's matching contributions to a retirement plan. Matching contributions must now be fully vested after only three years, versus five years previously. For plans that use an incremental vesting schedule, contributions must be fully vested at six years versus seven previously.

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THE HIGH-YIELD DOW INVESTMENT STRATEGY

We are convinced that long-term, common-stock investors will receive superior returns on the "large-capitalization-value stocks" component of their holdings when they consistently hold the highest-yielding Dow stocks. The fact that a given company's stock is included in the Dow Jones Industrial Average is evidence that the company is a mature and well-established going concern. When a Dow stock comes on the list of the highest-yielding issues in the Average, it will be because the company is out of favor with the investing public for one reason or another (disappointing earnings, unfavorable news developments, etc.) and its stock price is depressed. A High-Yield Dow (HYD) strategy derives much of its effectiveness because it forces the investor to purchase sound companies when they are out of favor and to sell them when they return to relative popularity.

Selecting from the list will not be cut and dried if the timing of purchases and sales reflects individual prejudices or other *ad hoc* considerations. These usually come down to "I'm not going to buy *that*" or "goody, this fine company has finally come on the list and I'm going to load up." Our experience with investing in the highest-yielding Dow stocks has shown that attempts to "pick and choose" usually do not work as well as a disciplined approach.

Our parent has exhaustively researched many possible High-Yield Dow approaches, backtesting various possible selections from the DJIA ranked by yield for various holding periods. For the 35 years ended in December 1998, they found that the best combination of total return and low risk (volatility) was obtained by purchasing the four highest-yielding issues and holding them for 18 months. (For a thorough discussion of the strategy for investing in the highest-yielding stocks in the DJIA, please read AIER's booklet, "How to Invest Wisely", $12.)

The model portfolio of HYD holdings set forth in the accompanying table reflects the systematic and gradual accumulation the four highest-yielding Dow issues that are neither General Motors nor Philip Morris. We exclude GM because its erratic dividend history has usually rendered its relative yield ineffective as a means of signaling timely purchases, especially when it has ranked no. 4 or higher on the list. We exclude Philip Morris because, in present circumstances, it seems unlikely that there will be sufficient "good news" for it to be sold out of the portfolio. For more than eight years, Philip Morris has never ranked lower than fourth on the list, whatever its ups and downs, and, given the circumstances, using Philip Morris in the strategy amounts to a buy-and-hold approach. The HYD strategy, to repeat, derives much of its superior performance from buying cheap and selling dear.

In the construction of the model, shares purchased 18 months earlier that are no longer eligible for purchase are sold. The hypothetical trades used to compute the composition of the model (as well as the returns on the model and on the full list of 30 Dow stocks) are based on mid-month closing prices, plus or minus $0.125 per share. Of the four stocks eligible for purchase this month, only **SBC Communications** was not eligible for purchase 18 months earlier (in June 2001), and one issue that was eligible for purchase 18 months ago, **International Paper** is not eligible this month. Investors following the model should find that the indicated purchases of SBC and sales of International Paper are sufficiently large to warrant trading. In larger accounts, rebalancing may warrant additional purchases of **JP Morgan Chase** as the model calls for adding to positions that have lagged the entire portfolio. Investors with sizable holdings may be able to track the exact percentages month to month, but smaller accounts should trade less often to avoid excessive transactions costs, only adjusting their holdings toward the percentages in the table if prospective commissions will be less than, say, one percent of the value of a trade. By making such adjustments from time to time, investors should achieve results

As of December 13, 2002

	Rank	Yield	Price	Status	Percent of Portfolio* Value	Percent of Portfolio* No. Shares†
Philip Morris	1	6.25%	40.98	*		
JP Morgan Chase	2	5.76%	23.62	Holding**	20.3	28.4
General Motors	3	5.48%	36.52	*		
Eastman Kodak	4	4.89%	36.81	Holding**	29.8	26.7
SBC Comm.	5	4.19%	25.75	Buying	13.1	16.8
Dupont	6	3.29%	42.56	Holding**	24.9	19.3
Honeywell Int'l	7	3.16%	23.71	—	—	—
Caterpillar	8	3.14%	44.60	Holding	11.9	8.8
Int'l Paper	9	2.92%	34.23	Selling	0.0	0.0
					100.0	100.0

Change in Portfolio Value‡

	1 mo.	1 yr.	5 yrs.	10 yrs.	15 yrs.	From 12/63	Std. Dev.
Strategy	3.0%	-2.2%	5.1%	13.6%	16.3%	15.6%	18.9
Dow	1.6%	-12.3%	2.9%	11.9%	12.9%	10.3%	17.0

* The strategy excludes Philip Morris and General Motors. ** Currently indicated purchases approximately equal to indicated purchases 18 months ago. ‡ Assuming all purchases and sales at mid-month prices (+/–$0.125 per share commissions), reinvestment of all dividends and interest, and no taxes. The 5-, 10- and 15-year total returns are annualized as are the total returns and the standard deviations of those returns since December 1963. † Because the percentage of each issue in the portfolio by value reflects the prices shown in the table, we are also showing the number of *shares* of each stock as a percentage of the total number of shares in the entire portfolio.

Note: These calculations are based on hypothetical trades following a very exacting stock-selection strategy, and are gross of any management fees. They do not reflect returns on actual investments or previous recommendations of AIS. Past performance may differ from future results.

roughly equal to the future performance of the model.

The process of *starting* to use the strategy is not as straightforward. The two most extreme approaches are: 1) buy all the indicated positions at once or 2) spread purchases out over 18 months. Either choice could be said to represent an attempt at market timing, i.e., buying all at once could be construed as a prediction that (and will look good in retrospect only if) the prices of the shares go up after the purchases are made. On the other hand, if purchases are stretched out and stock prices increase, the value of the investor's holdings will lag behind the strategy's performance. We believe that most attempts to time the market are futile, and the best course lies somewhere in between the extremes.

Some portion of the shares now held in the strategy will be sold within a few months. The shares most likely to be sold are those whose indicated yields are too low to make them currently eligible for purchase. This usually means that their prices have risen (and their yields have fallen) in relative if not absolute terms, since they were purchased. If such stocks are purchased now and are sold within a few months, the investor will receive only a portion of the profit, or sustain a greater loss, than the strategy. On the other hand, if the stocks not currently eligible for purchase are bought and the strategy does not call for selling them soon, it will usually be because their prices have decreased so that their indicated yields render them again eligible for purchase. In other words, buying a stock that is not currently among the top four means that it will very likely be sold during the months ahead (perhaps at a gain, perhaps not, but with payment of two commissions either way). Alternatively, if the price decreases so that the issue again becomes eligible for purchase, then the investor's initial purchase would be likely to be held in the portfolio at a loss for some period of time. In the latter situation, the investor would have been better off waiting.

Accordingly, for new HYD clients, we usually purchase the complement of the currently eligible stocks without delay. (This month, the four eligible issues—SBC Communications, Caterpillar, Eastman Kodak, and J.P. Morgan Chase—account for a little more than two-thirds of the total portfolio value). Any remaining cash will be held in a money-market fund pending subsequent purchases, which will be made whenever the client's holdings of each month's eligible stocks are below the percentages indicated by the strategy by an amount sufficient to warrant a trade.

Our **HYD Investment Management Program** provides professional and disciplined application of this strategy for individual accounts. For accounts of $100,000 or more, the fees and expenses of AIS's discretionary portfolio management programs are comparable to those of many index mutual funds. Contact us for information on this and our other discretionary investment management services.

THE DOW JONES INDUSTRIALS RANKED BY YIELD

	Ticker Symbol	Market Prices 12/13/02	Market Prices 11/15/02	Market Prices 12/14/01	12-Month High	12-Month Low	Latest Dividend Amount	Latest Dividend Record Date	Latest Dividend Paid	Indicated Annual Dividend	Indicated Yield† (%)
Philip Morris	MO	**$40.98**	38.06	45.81	57.79	35.40	0.640	9/16/02	10/10/02	2.560	6.25
★ J. P. Morgan Chase	JPM	**$23.62**	22.09	36.04	39.68	15.26	0.340	1/06/03	1/31/03	1.360	5.76
General Motors	GM	**$36.52**	35.07	47.48	68.17	30.80	0.500	11/14/02	12/10/02	2.000	5.48
★ Eastman Kodak	EK	**$36.81**	34.74	30.58	38.48 *H*	25.58	0.900	11/01/02	12/13/02	1.800	4.89
★ SBC Comm.	SBC	**$25.75**	25.19	38.95	40.99	19.57	0.270	10/10/02	11/01/02	1.080	4.19
★ DuPont	DD	**$42.56**	42.63	41.49	49.80	35.02	0.350	11/15/02	12/14/02	1.400	3.29
Honeywell Intl.	HON	**$23.71**	23.38	31.69	40.95	18.77	0.188	11/20/02	12/10/02	0.750	3.16
☆ Caterpillar	CAT	**$44.60**	45.08	50.07	59.99	33.75	0.350	10/21/02	11/20/02	1.400	3.14
General Electric	GE	**$25.50**	23.86	37.65	41.84	21.40	0.190	12/31/02	1/27/03	0.760	2.98
☆ International Paper	IP	**$34.23**	35.73	39.40	46.20	31.35	0.250	11/22/02	12/16/02	1.000	2.92
Exxon Mobil	XOM	**$35.04**	34.85	36.86	44.58	29.75	0.230	11/12/02	12/10/02	0.920	2.63
Alcoa	AA	**$23.03**	22.93	37.02	39.75	17.62	0.150	11/08/02	11/25/02	0.600	2.61
Merck	MRK	**$57.34**	55.37	58.09	64.50	38.50	0.360	12/06/02	1/02/03	1.440	2.51
Boeing	BA	**$31.40**	31.50	37.55	51.07	28.53	0.170	2/07/03	3/07/03	0.680	2.17
3M Company	MMM	**$121.77**	129.50	115.80	131.55 *H*	100.00	0.620	11/22/02	12/12/02	2.480	2.04
Citigroup	C	**$36.00**	36.90	46.69	52.20	24.42	0.180	11/04/02	11/22/02	0.720	2.00
Procter & Gamble	PG	**$87.41**	87.28	79.90	94.75	74.08	0.410	10/18/02	11/15/02	1.640	1.88
Coca-Cola	KO	**$45.85**	45.97	46.25	57.91	43.50	0.200	12/01/02	12/15/02	0.800	1.74
Hewlett-Packard	HPQ	**$18.58**	16.90	21.00	24.12	10.75	0.080	12/18/02	1/08/03	0.320	1.72
United Tech.	UTX	**$60.10**	63.02	61.46	77.75	48.83	0.245	11/15/02	12/10/02	0.980	1.63
Johnson & Johnson	JNJ	**$54.91**	60.15	56.30	65.89	41.40	0.205	11/19/02	12/10/02	0.820	1.49
McDonald's	MCD	**$17.34**	17.38	26.80	30.72	15.75	0.235	11/15/02	12/02/02	0.225	1.30
Walt Disney	DIS	**$16.52**	18.53	20.97	25.17	13.48	0.210	12/13/02	1/09/03	0.210	1.27
Home Depot, Inc.	HD	**$26.39**	28.32	49.81	52.60	23.18	0.060	12/05/02	12/19/02	0.240	0.91
American Express	AXP	**$35.94**	37.65	32.26	44.91	26.55	0.080	1/03/03	2/10/03	0.320	0.89
IBM	IBM	**$80.00**	80.01	121.10	126.39	54.01	0.150	11/08/02	12/10/02	0.600	0.75
Wal-Mart Stores	WMT	**$50.54**	55.49	54.06	63.94	43.72	0.075	12/20/02	1/06/03	0.300	0.59
AT&T (r)	T	**$27.56**	13.86	16.13	19.25	5.04 *L*	0.000	11/15/02	11/18/02	0.150	0.54
Intel Corp.	INTC	**$17.58**	18.80	33.27	36.78	12.95	0.020	11/07/02	12/01/02	0.080	0.46
Microsoft Corp.	MSFT	**$52.50**	56.69	67.44	70.62	41.41	0.000	-	-	0.000	0.00

★ BUY. ☆ HOLD. † Based on indicated dividends and market price as of 12/13/02 *H* New 52-week high. *L* New 52-week low. (s) All data adjusted for splits. (r) All data adjusted for reverse splits.

Note: The issues indicated for purchase (★) are the 4 highest yielding issues (other than Philip Morris and General Motors) qualifying for purchase in the top 4-for-18 months model portfolio. The issues indicated for retention (☆) have similarly qualified for purchase during one or more of the preceding 17 months, but do not qualify for purchase this month.

RECENT MARKET STATISTICS

Precious Metals & Commodity Prices

	12/13/02	Mo. Earlier	Yr. Earlier
Gold, London p.m. fixing	**332.20**	319.10	277.05
Silver, London Spot Price	**4.74**	4.55	4.36
Copper, COMEX Spot Price	**0.72**	0.72	0.67
Crude Oil, W. Texas Int. Spot	**28.44**	25.51	19.23
Dow Jones Spot Index	**143.56**	135.55	97.30
Dow Jones-AIG Futures Index	**109.30**	102.22	88.97
CRB-Bridge Futures Index	**234.78**	227.13	191.07

Interest Rates (%)

		12/13/02	Mo. Earlier	Yr. Earlier
U.S. Treasury bills -	91 day	**1.20**	1.21	1.72
	182 day	**1.26**	1.25	1.82
	52 week	**1.39**	1.43	2.20
U.S. Treasury bonds -	15 year	**4.73**	4.71	5.81
Corporates:				
High Quality -	10+ year	**6.08**	6.09	6.90
Medium Quality -	10+ year	**6.97**	7.13	7.71
Federal Reserve Discount Rate		**0.75**	0.75	1.25
New York Prime Rate		**4.25**	4.25	4.75
Euro Rates	3 month	**2.99**	3.21	3.35
Government bonds -	10 year	**4.48**	4.56	4.62
Swiss Rates -	3 month	**0.74**	0.74	1.88
Government bonds -	10 year	**2.45**	2.57	3.21

Exchange Rates

	12/13/02	Mo. Earlier	Yr. Earlier
British Pound	**$1.589900**	1.578900	1.456100
Canadian Dollar	**$0.640400**	0.631900	0.640700
Euro	**$1.020800**	1.006500	0.904900
Japanese Yen	**$0.008267**	0.008251	0.007826
South African Rand	**$0.114300**	0.104200	0.083800
Swiss Franc	**$0.692100**	0.685700	0.612700

Securities Markets

	12/13/02	Mo. Earlier	Yr. Earlier
S & P 500 Stock Composite	**889.48**	909.83	1,123.09
Dow Jones Industrial Average	**8,433.71**	8,579.09	9,811.15
Dow Jones Transportation Average	**2,318.47**	2,333.20	2,577.10
Dow Jones Utilities Average	**209.10**	200.34	278.15
Dow Jones Bond Average	**155.30**	152.78	102.71
Nasdaq Composite	**1,362.42**	1,411.14	1,953.17
Financial Times Gold Mines Index	**1,278.44**	1,139.51	854.97
FT African Gold Mines	**2,372.18**	2,011.98	985.48
FT Australasian Gold Mines	**1,697.05**	1,465.83	1,119.10
FT North American Gold Mines	**973.39**	889.38	775.46

Coin Prices

	12/13/02	Mo. Earlier	Yr. Earlier	Premium
American Eagle (1.00)	**$334.15**	329.45	284.35	0.59
Austrian 100-Corona (0.9803)	**$318.33**	313.83	270.93	-2.25
British Sovereign (0.2354)	**$80.25**	79.15	68.75	2.62
Canadian Maple Leaf (1.00)	**$334.40**	329.70	284.60	0.66
Mexican 50-Peso (1.2057)	**$392.80**	387.40	334.50	-1.93
Mexican Ounce (1.00)	**$325.70**	321.10	277.20	-1.96
S. African Krugerrand (1.00)	**$331.05**	326.45	282.15	-0.35
U.S. Double Eagle-$20 (0.9675)				
St. Gaudens (MS-60)	**$395.00**	400.00	335.00	22.90
Liberty (Type I-AU)	**$675.00**	675.00	675.00	110.02
Liberty (Type II-AU)	**$385.00**	385.00	385.00	19.79
Liberty (Type III-AU)	**$362.50**	367.50	312.50	12.79
U.S. Silver Coins ($1,000 face value)				
90% Silver (715 oz.)	**$4,550.00**	4,600.00	4,500.00	34.25
40% Silver (292 oz.)	**$1,587.50**	1,575.00	1,525.00	14.70
Silver Dollars	**$6,075.00**	6,037.50	5,850.00	65.67

Note: Premium reflects percentage difference between coin price and value of metal in a coin, with gold at $332.20 per ounce and silver at $4.74 per ounce. The weight in troy ounces of the precious metal in coins is indicated in parentheses.

Recommended Mutual Funds

	Ticker Symbol	12/13/02	Month Earlier	Year Earlier	52-Week High	52-Week Low	Distributions Latest 12 Months Income	Distributions Latest 12 Months Capital Gains	Yield (%)
Short-Term Bond Funds									
★ iShares Lehman 1-3 Yr Treasury	SHY	**$81.90**	81.84	NA	82.17	81.00	0.3853	0.0000	1.88
★ Fidelity Target Time Line 2003	FTARX	**$9.54**	9.53	9.49	9.57	9.41	0.3746	0.0000	3.93
★ USAA Short Term Bond	USSBX	**$8.98**	8.97	9.48	9.62	8.89	0.4923	0.0000	5.48
★ Vanguard Short-term Corporate	VFSTX	**$10.73**	10.70	10.78	10.89	10.58	0.5852	0.0000	5.45
Income Equity Funds									
★ DNP Select Income[1, 2]	DNP	**$9.87**	9.60	11.02	11.62	7.85	0.7800	0.0000	7.90
★ Vanguard REIT Index	VGSIX	**$11.98**	11.85	12.24	13.69	10.94	0.7059	0.0641	5.89
Large Cap. Value Equity Funds									
★ iShares S&P 500 Value Index[3]	IVE	**$43.20**	43.80	53.77	56.94	35.91	0.7824	0.1472	1.81
★ Vanguard Value Index	VIVAX	**$14.77**	14.94	18.54	19.46	12.38	0.3060	0.1070	2.07
Small Cap. Value Equity Funds									
★ iShares Sm. Cap. 600 Value Index[3]	IJS	**$73.50**	71.90	82.68	99.67	62.50	0.6224	0.3430	0.85
★ Vanguard Sm. Cap Value Index	VISVX	**$8.72**	8.49	10.08	11.66	7.43	0.0650	0.3810	0.75
Growth Equity Funds									
★ iShares S&P 500 Growth Index[3]	IVW	**$45.75**	47.30	58.62	61.21	40.02	0.4389	0.1124	0.96
★ Vanguard Growth Index	VIGRX	**$20.38**	21.01	26.11	26.98	18.25	0.2320	0.0000	1.14
Foreign Equity Funds									
★ iShares S&P Europe 350 Index[3]	IEV	**$47.46**	49.76	57.65	60.78	41.40	0.9307	0.0000	1.96
T Rowe Price European Stock	PRESX	**$12.86**	13.21	15.43	16.27	11.34	0.0000	0.0000	0.00
★ Vanguard European Stock Index	VEURX	**$15.97**	16.85	19.96	20.56	14.55	0.8400	0.0000	5.26

Recommended Gold-Mining Companies

	Ticker Symbol	12/13/02	Month Earlier	Year Earlier	52-Week High	52-Week Low	Distributions Latest 12 Months	Distributions Frequency	Yield (%)
Anglo American PLC, ADR	AAUK	**$13.94**	13.90	15.50	19.61	10.84	0.460	Semiannual	3.30
★ Anglogold Ltd., ADR	AU	**$33.99**	29.85	18.73	34.66	17.35	0.649	Semiannual	1.91
ASA Ltd.[1]	ASA	**$39.30**	31.40	20.50	40.44	19.45	0.600	Quarterly	1.53
★ Barrick Gold Corp.†	ABX	**$16.00**	15.99	16.37	23.49	13.46	0.220	Semiannual	1.38
★ Gold Fields Ltd.	GFI	**$14.68**	11.73	5.20	17.15	4.65	0.111	Semiannual	0.76
★ Newmont Mining	NEM	**$29.00**	25.18	19.72	32.75	18.52	0.120	Quarterly	0.41
★ Placer Dome†	PDG	**$11.36**	10.04	11.27	14.74	7.91	0.100	Semiannual	0.88
★ Rio Tinto PLC‡	RTP	**$77.60**	78.65	74.00	86.00	61.10	2.350	Semiannual	3.03

★ Buy. ☆ Hold. (s) All data adjusted for splits. † Dividend shown is after 15% Canadian tax withholding. ‡ Dividend shown is after 15% U.K. tax withholding on a portion of the total. na Not applicable. [1] Closed-end fund, traded on the NYSE. [2] Dividends paid monthly. [3] Exchange traded fund, traded on ASE.

The information herein is derived from generally reliable sources, but cannot be guaranteed. American Investment Services, the American Institute for Economic Research, and the officers, employees, or other persons affiliated with either organization may from time to time have positions in the investments referred to herein.